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98-05162-R

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

IN RE:)
)
COMMERCIAL FINANCIAL SERVICES,)
INC. AND CF/SPC NGU, INC.,)
)
Debtor,)
)
CAROL SPANGLER, JOHN BACHMAN, and)
BRUCE PHELPS,)
)
Appellants,)
)
v.)
)
COMMERCIAL FINANCIAL SERVICES,)
)
Appellee.)

FILED
APR 27 2000
Phil Lombardi, Clerk
U.S. DISTRICT COURT

Case No. 99-CV-380-H(M)✓

Case No. 99-CV-390-H(M)

ENTERED ON DOCKET
DATE APR 27 2000

ORDER

This matter comes before the Court on appeal from the United States Bankruptcy Court for the Northern District of Oklahoma. The appeal was referred to a United States Magistrate Judge for report and recommendation. Magistrate Judge McCarthy's Report and Recommendation (Docket # 12) and the Objection To Report and Recommendation of Magistrate of Appellants John Bachman and Bruce Phelps ("Appellants") (Docket # 13) are before the Court. Appellant Carol Spangler ("Spangler") filed no objections to the Report and Recommendation of the Magistrate.

On appeal, Appellants assert that the Bankruptcy Court erred in holding that lump sum termination payments owed them by Appellee CFS were not administrative expense claims under Section 503(b) of the Bankruptcy Code and therefore were not entitled to first priority in distribution under Section 507(a)(1) of the Bankruptcy Code. Appellants primarily argue that

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their lump sum termination payments are severance pay claims and are therefore entitled to administrative priority under In Re Amarex, 853 F.2d 1526 (10th Cir. 1988). Appellants further claim that Appellee fraudulently induced them to continue performing under their written employment agreements. In her brief, Appellant Spangler argues only that her severance pay claim is entitled to administrative priority under Amarex.

In his Report and Recommendation, the magistrate judge found that the Bankruptcy Court correctly held that Appellants' lump sum termination payments were not administration expenses under 11 U.S.C. § 503(b)(1)(A), and therefore recommended that this Court affirm the decision of the Bankruptcy Court. The magistrate judge further found that appellants had failed to raise its fraud claims before the Bankruptcy Court, and as a result, recommended that the Court grant Appellee's motion to strike from Appellants' brief the matters not presented to the Bankruptcy Court. Finally, the magistrate judge concluded that Appellants' conduct in raising these issues on appeal was not of a nature to require imposition of sanctions and recommended that this Court deny Appellee's request for sanctions.

In accordance with 28 U.S.C. § 636 and Fed.R.Civ.P. 72(b), the Court has reviewed the Bankruptcy Court's conclusions of law and the magistrate judge's report and recommendation de novo. The Court finds that the Bankruptcy Court correctly held that the lump sum termination payment clauses were not entitled to administrative expense priority under 11 U.S.C. § 503(b)(1)(A), and therefore adopts the report and recommendation of the magistrate judge.

In its opinion, the Bankruptcy Court held that Appellants' post termination lump sum claims could not be characterized as "necessary costs and expenses of preserving the estate" under 11 U.S.C. § 503(b)(1)(A), nor could they be considered compensation for Appellants' post-

petition services. The Bankruptcy Court further rejected Appellants' contention that Tenth Circuit authority dictates that such claims be afforded administrative expense priority. Accordingly, the Bankruptcy Court concluded that because Appellants' claims neither arise from transactions with the debtor-in-possession, nor benefit the debtor-in-possession, they are not entitled to administrative expense priority under 11 U.S.C. § 503(b)(1)(A).

Appellants appeal from the decision of the Bankruptcy Court, asserting that in In re Amarex, 853 F.2d 1526 (10th Cir. 1988), the Tenth Circuit adopted the rationale of all other Courts of Appeals to consider the issue and held that severance pay is correctly classified as an administrative priority expense under 11 U.S.C. § 503(b)(1)(A). Appellants further argue that because CFS permitted them to remain in their pre-petition positions, their claims arose out of a transaction with the debtor-in-possession. Finally, Appellants claim that by continuing to perform their job duties, they provided a benefit to the debtor-in-possession.

Based upon a careful review of the opinion of the Bankruptcy Court, the submissions of the parties, and the relevant case law, the Court finds that the Bankruptcy Court correctly analyzed this issue. The Court rejects Appellants' contention that the Tenth Circuit, in Amarex, held that severance pay is subject to administrative expense priority, or that all other Courts of Appeals to consider the issue have so held. Amarex required the Tenth Circuit to determine the administrative expense classification of a bonus payment, not of severance pay. Therefore, any statement in Amarex regarding the treatment of severance pay under Section 503 is necessarily dicta. Furthermore, the court in Amarex recognized that "there is some disagreement among circuit courts concerning the extent to which severance pay should be accorded priority as an administrative expense." Amarex, 853 F.2d at 1531, n. 5. Finally, the Amarex court explicitly

adopted the analysis utilized by the First Circuit in In re Mammoth Mart, 536 F.2d 950. The Mammoth Mart court rejected as unpersuasive the rationale that Appellants suggest was adopted by the Amarex Court, that severance pay compensation for termination of employment and therefore entitled to administrative expense priority. See 539 F.2d at 955.

Having rejected the notion that Amarex stands for the proposition that severance pay is automatically subject to administrative expense priority, the Court further finds that the Bankruptcy Court correctly applied the Mammoth Mart test adopted by the Amarex court. Under this test, to be entitled to first priority as an administrative expense under 11 U.S.C. § 503(b)(1)(A), a claim must arise from a transaction with the debtor in possession, and the consideration supporting the claim must have been beneficial to the debtor-in-possession. See Amarex, 853 F.2d at 1530 n. 4.

Appellants first argue that because the lump sum termination clauses were part of their employment agreements with the debtor, and because the debtor-in-possession allowed them to remain in their pre-petition positions, their claims arise from a transaction with the debtor-in-possession. The Court finds that the Bankruptcy Court correctly rejected this argument. "It is only when the debtor-in-possession's actions themselves, that is, considered apart from any obligation of the pre-petition debtor, give rise to a legal liability, that the claimant is entitled to the priority of a cost and expense of administration." Mammoth Mart, 539 F.2d at 955. It is clear from the record in this case that the lump sum termination clauses were negotiated with the pre-petition debtor, and not the debtor-in-possession. Accordingly, the Court concludes that Appellants' claims do not arise from a transaction with the debtor-in-possession.

Next, Appellants assert that by remaining in their positions, they conveyed a benefit to the

debtor-in-possession. However, mere conveyance of a benefit does not satisfy the second prong of the Mammoth Mart test. In order for a claim to be entitled to administrative priority, "the consideration supporting the claimant's right to payment [must have been] beneficial to the debtor-in-possession in the operation of the business." Amarex, 853 F.2d at 1530 n. 4. The Bankruptcy Court found that the debtor-in-possession had itself determined that the Appellants' services were not beneficial to the estate by rejecting their pre-petition employment agreements. The Bankruptcy Court further found that Appellants' right to the lump sum termination payments vested immediately upon execution of the employment agreements, and that therefore, their completion of post-petition tasks did not serve as consideration for the lump sum termination payments. Finally, the Bankruptcy Court observed that to the extent that Appellants had performed any post-petition services, they had been fully compensated for those services. The Court finds that the Bankruptcy Court correctly analyzed this issue. To the extent that Appellants provided any benefit to the debtor-in-possession, that benefit (1) did not serve as consideration supporting their claim to the lump sum termination payments, and (2) was fully compensated.

Accordingly, the Court finds that Appellants have failed to satisfy the Mammoth Mart/Amarex requirements for establishing entitlement to administrative expense priority under 11 U.S.C. § 503(b)(1)(A). Furthermore, the Court finds that Appellants failed to raise their fraud claims before the Bankruptcy Court and therefore concludes that Appellee's motion to strike those claims should be granted.


Applying the above analysis to Appellant Spangler's claim, the Court finds that Spangler has also failed to establish either that her claim arises from a transaction with the debtor-in-possession, or that the consideration supporting her claim conveyed a benefit to the debtor-in-

possession, and therefore finds that her claim is not entitled to administrative expense priority under 11 U.S.C. § 503(b)(1)(A).

For the reasons set forth above, the Court concludes that the Magistrate's Report and Recommendation (Docket # 5) should be adopted, and the decision of the Bankruptcy Court is hereby AFFIRMED.

IT IS SO ORDERED.

This 27TH day of April, 2000.


Sven Erik Holmes
United States District Judge